

## PREFATORY NOTE

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Federal Open Market Committee

Conference Call

October 16, 1989

PRESENT: Mr. Greenspan, Chairman  
Mr. Corrigan, Vice Chairman  
Mr. Angell  
Mr. Guffey  
Mr. Johnson  
Mr. Keehn  
Mr. LaWare  
Mr. Melzer  
Mr. Syron

Messrs. Boehne, Boykin, and Stern, Alternate  
Members of the Federal Open Market Committee

Messrs. Black, and Forrestal, Presidents of the  
Federal Reserve Banks of Richmond and  
Atlanta, respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Assistant Secretary  
Mr. Gillum, Deputy Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Prell, Economist  
Mr. Truman, Economist

Messrs. Lindsey and Promisel, Associate Economists

Mr. Sternlight, Manager for Domestic Operations,  
System Open Market Account  
Mr. Cross, Manager for Foreign Operations,  
System Open Market Account

Mr. Coyne, Assistant to the Board, Board of  
Governors  
Mr. Wiles, Secretary of the Board, Board of  
Governors  
Ms. Low, Open Market Secretariat Assistant,  
Division of Monetary Affairs, Board of  
Governors

Messrs. Doyle and Powell, First Vice Presidents,  
Federal Reserve Bank of Chicago and  
San Francisco, respectively

Transcript of Federal Open Market Committee Conference Call of  
October 16, 1989

CHAIRMAN GREENSPAN. Good morning, everyone. As the clock ticks toward 9:30, one gets the impression of looking at a Cape Canaveral blast off. Before we get into any formal business, there are a couple of announcements I want to make. One is that this may be the first of several meetings the FOMC probably will have this week. I thought that in October of 1987 there was considerable usefulness in having the daily meetings that we had. And if we were to maintain that sort of schedule during this crisis period, I think it will be to our advantage--if that's at all feasible. Secondly, let me just indicate to those to whom I haven't spoken that those articles in The Washington Post and The New York Times yesterday were not authorized releases. They were not done by myself nor anyone I'm aware of. I'm not sure at this stage particularly what damage was done, but it clearly has very severely restricted our options, or it could. I hope that during this period everyone will endeavor to stay away from the press. If you feel an absolute necessity to speak to them for purposes of education, please make it off-the-record and make certain they know that off-the-record means that no indication of that conversation or relationship to the Fed is involved. The safest thing to do is just not to say anything to anybody, because there is going to be tremendous media hype on the Fed and I think we have to be very careful about inadvertently exposing the markets to some statement which was made in all innocence and which, as a consequence of the media hype, is pushed all out of regard to what the underlying meaning was. So, let me just say: Please be careful. Anyone who speaks for the Fed speaks for all of us and we have to be careful of that.

VICE CHAIRMAN CORRIGAN. Mr. Chairman, if I could, I'd like to add a point on those unfortunate press articles. It is clear to me that they have already done some damage in terms of reducing [our] flexibility and undermining discipline in the marketplace. It is absolutely essential, regardless of what the motivation for those particular articles may have been, that there is only one person who speaks for the Federal Reserve in these circumstances and that is you. I regard those press reports as amateurish. [Furthermore], I think they undercut the character of the Federal Reserve as I have known it for many, many years. The only saving grace that I can think of is that, in a way, they are so amateurish that they probably will not be taken as seriously as they might have been. The person, at least in The Washington Post, goes to the great length of having, in effect, announced policy and then turns around and says that we aren't going to make an announcement about policy. I think it is very, very unfortunate. And it does cut right at the very heart of the Federal Reserve, as far as I'm concerned.

CHAIRMAN GREENSPAN. I think it would be useful this morning to start off with Sam Cross bringing us up to date on international events.

MR. CROSS. Mr. Chairman, when we closed here in New York on Friday, the dollar was trading at about 142 yen and 1.87 mark. Now, that was at 4:00 o'clock, and the dollar did slip a little further after that in fairly chaotic circumstances. In Asia and in Europe overnight last night, the dollar slipped a bit from the rates that I mentioned, but all-in-all the performance, I think, has been

reasonably good. The lowest that we saw last night and this morning was in Asia where the dollar hit 1.83 or so in the mark and 139, or around that level, in the yen. These rates were hit pretty soon after markets began to open up in Asia last night. During most of the evening and morning the rates were fairly steady and even drifted up somewhat. So, at the present time, we have rates against the yen at about 140.5 and against the mark at about 1.845. Obviously, they are all very edgy and very nervous and are anxiously awaiting what happens to stocks. But on the whole, the dollar has performed reasonably stably. Thank you.

CHAIRMAN GREENSPAN. Okay. Peter Sternlight, are you there?

MR. STERNLIGHT. Yes, I am, Mr. Chairman. Let me start with just a brief comment about what the markets had been doing from the time of your last meeting at the beginning of October up until last Friday. Rates had come off moderately--say, 10 to 40 basis points for bills; 35 to 45 in the 2-to-5-year area; and about 20 basis points for the long bond. I think this was against the background of some feeling in the market that perhaps a further easing move, which had been lurking in the back of people's minds, was maybe becoming a little more imminent, particularly when the employment report was released in early October. Then on Friday, in the aftermath or along with the very sharp drop in stocks, there was a flight to quality and rates came down appreciably further. So, now the change--again from October 2nd--would be off about 80 basis points or so in the bill area, about 65 to 85 in the short Treasury coupons, and about 35 to 40 basis points for the 30-year bonds.

This morning we are getting a small taking back of some of those big gains late Friday, but there would still be these appreciable declines since the beginning of October. Given that there was a kind of flight to quality, we didn't have that move across the whole range of prices, so something like the [unintelligible] spread has widened about 15 basis points or so, and the spread of Eurodollar CD rates against Treasury bills widened out a bit on Friday. In other parts of the market, of course, the junk bonds were not sharing in the moderate decline in rates earlier in the month and they came under further pressure on Friday. I don't have a particular yield change to quote, because that market has been so illiquid it's very hard to get a sensible reading; but clearly, that high-yield junk market has been under pressure and there is very limited market-making in those bonds. In terms of federal funds, we had been right around 9 percent at the time of the Committee meeting at the beginning of the month. Since then, rates have been a little under that, hovering around 8-7/8 percent. We were mostly in a reserve-draining mode through this period. That included taking out a moderate amount of reserves this past Friday. Rates softened further after that, despite our having taken some funds out. And this morning we started with a funds quote of 8-5/8 percent and it has drifted off at 8-9/16 percent. I haven't seen any new reserve numbers yet, but based on what we were looking at on Friday, we thought we still had a little more draining of reserves to do. The market, of course, has seen these headlines that have been referred to, and frankly, I'm not sure what they expect of us in light of that, but also [in light of] the obviously comfortable funds market. That's all I have, Mr. Chairman.

CHAIRMAN GREENSPAN. Okay. Are there any questions for either Mr. Cross or Mr. Sternlight?

MR. BOEHNE. This is Ed Boehne. Peter, what's happening in the corporate bond market other than the junk bond piece of it?

MR. STERNLIGHT. Well, the yields were coming off in the early October week, kind of along with Treasury issues. I couldn't really get a good read on what happened to those in the Friday market, Ed. Well, I just won't speculate on it. It was certainly not like the pounding that the junk market took, but I don't know that they got the benefit of the big lift--I doubt it--that the Treasuries got either.

CHAIRMAN GREENSPAN. Any other questions for them? If not, Si Keehn, would you bring us up to date on what you think is going on in Chicago?

MR. KEEHN. Mr. Chairman, the two main markets out here this morning are viewed as being reasonably comfortable, under the circumstances. The margin calls following Friday's activity have been met. At the Merc the [unintelligible] was about 808; foreign trading was a little over \$300 million and those are both up. As I say, at the opening of the Fedwire this morning [unintelligible] viewed both of these changes as being especially helpful. Other than that, banks seem comfortable in providing funds to meet these margin calls. As you know, one dealer failed; he's not a major dealer, but there was a [buyer] over the weekend. The purpose was to get that behind them so they wouldn't have that failure staring at them at the opening of business. [Unintelligible] packages being put together, and that has been doubled. I think everyone out here views the key as being what's going to happen on the New York stock exchange this morning. Everyone's waiting; that's what's taking place here. Apparently, things seem to be reasonably comfortable.

CHAIRMAN GREENSPAN. Jerry Corrigan, do you have anything new that might be useful to us?

VICE CHAIRMAN CORRIGAN. First of all, in terms of European stock markets, the general pattern is that stocks are down in the range of 7 to 9 percent on the major exchanges. London reached a low of down 204, over 9 percent. Right now it's down 175 or so, which is just a shade under 8 percent. That pattern pretty well prevails through most of the other exchanges, although patterns of trade, especially in Paris, are very, very irregular. The reports we are getting out of London in particular suggest that as of now and unlike 1987, there is no panic selling and there is not a widespread pattern of names of individual counterparties for transactions being questioned in the way that they were in 1987--although there, too, everyone is waiting to see how markets open here in New York. We've just been told that the New York Stock Exchange opening is going to be delayed another 15 minutes. I may have to pick up a call from in just a second to see what he has to say. The Tokyo markets were typically Japanese: everything was very quiet, all things considered in Tokyo; stocks closed down only about 1.28 percent with very, very low levels of trading. Apparently, the institutions stayed completely on the sidelines.

Here, as I said, market expectations about stocks are really all over the lot. I think that [most of] these people--the last time I talked to them about what they see--feel that stocks will open in New York down maybe 60, 80, or 100 points. But there are speculative judgments in the marketplace that are a good deal worse than that. Some people [unintelligible] are talking about stocks opening down as much as 200, but obviously those are just shots in the dark with little appreciation of what's going on.

tells me that he thinks that, on balance, U.S. stocks in London are about 3 percent below their close as of last Friday in New York. The one technical condition that exists that is a bit troubling is that the Chicago futures indexes at the close were about 5 points below cash margins. Now, what would normally happen in those circumstances, of course, is that the "arbs" would close them off. Whether they will or not depends on a lot of things including [unintelligible] judgments. Peter already mentioned the junk bond market. I think it's quite obvious that that market, at least today, will be rather totally illiquid. And that among other things raises the question of whether some of these mutual funds, especially those that have concentrated positions in junk issues, could come under some pressure. We think there is about \$40 billion of junk bonds in the funds. Of course, it's not all of the funds. There are a few [unintelligible] size are largely, if not exclusively junk; and of those, few are open ended. So that could possibly be quite a concern. But the prevailing attitude, at least at the moment, seems to me to be one in which most people do not [see] that situation as having the same character as 1987. I've got on the other phone, Alan. Can I take it?

CHAIRMAN GREENSPAN. Sure. Why don't you take it and I'll just continue on. Come on back, if you have time after you've finished, and let us know what he had to say.

When I contemplated this call before the market broke, I had been looking over a number of different things, including the increasing evidence of continued deterioration in profit margins in the third quarter and in orders, which have remained very soft and in some instances are slipping. I had thought it would be advisable as a consequence of that for us to initiate another small downward adjustment in monetary pressures. But these last events obviously have overtaken us. Since we will be talking over the next several days, I think any official policy position that we initiate can be held off for a few days until this whole thing simmers down and we know pretty much where we are.

VICE CHAIRMAN CORRIGAN. Alan, could I interrupt?

CHAIRMAN GREENSPAN. Sure.

VICE CHAIRMAN CORRIGAN. They are now open and it opened with a tick to the high side. There are 62,000 orders in the system. By way of contrast, the peak front load in 1987 was about 38,000. The initial ticks are slightly on the up side but there is such a large bunch of orders in the system that it will take another 10 or 15 minutes to know what they really have.

CHAIRMAN GREENSPAN. You mean the delay was a rush of orders just before the opening?

VICE CHAIRMAN CORRIGAN. Yes. As I said, there are 62,000 orders in the system, and by way of contrast the peak in orders in the system at the opening in 1987 was 38,000. The first cut was slightly to the up side but it will take another 15 minutes to know what they really have.

SPEAKER(?). The specialists are there.

CHAIRMAN GREENSPAN. As weird as that may seem. In any event, let me just throw in a view here that that may or may not be good news. If we have washed out the illiquidation, that's fine; but if this runs into selling resistance and starts its second tranche on the down side later in the day, it could create some problems for us. That is all the more reason why I think we should schedule another [call] for tomorrow morning at the same time, if that's feasible for everybody. But before we close are there any comments, questions, or motions of any of the Committee members?

MR. JOHNSON. Can I just make one? Jerry, how did CHIPS do? Were there any problems settling there this morning at all?

VICE CHAIRMAN CORRIGAN. No. We have been in touch with the Clearing House and, as Alan and I talked yesterday, we also called all the other Reserve Banks yesterday to make sure everybody had all their ducks in a row and all their people on board. So far, everything is just fine. There are no glitches anywhere that I know of. We'll just keep our fingers crossed.

MR. JOHNSON. Yes.

VICE CHAIRMAN CORRIGAN. One thing we don't want is any operating problems today.

MR. JOHNSON. Okay, thank you.

MR. BOEHNE. Jerry, I presume you've been in contact with the money center banks who are backing up the dealers. What percent was [unintelligible]? Presumably, they have read all the papers. What's the tone of [unintelligible] saying?

VICE CHAIRMAN CORRIGAN. Generally, Ed, it would be along the lines of what I started to say before I had to run off a moment ago: that people generally are concerned but they also seem to think that, in underlying terms, we may be a little better off than we were in '87. The major dominant concern is the spillover effects in high-yield markets; there is always the possibility that with markets as they are now, for firms that are trying to restructure an existing deal in bankruptcy it wouldn't take much for that kind of situation to get pretty ugly. I do think that they know what their role is. There was at least an element of confusion, if I can put it that way, growing out of some of those newspaper reports.

MR. BOEHNE. They know what their role is and they know what our role is.

VICE CHAIRMAN CORRIGAN. Yes. As I said, I think there is some uneasiness about those news reports. But basically my sense of it is that I can't say they're comfortable, but I get no sense of a

really--"panicky" is a bad word, but I'll use it anyway--panicky feeling. They seem okay at the moment.

MR. BOEHNE. They are still apprehensive.

VICE CHAIRMAN CORRIGAN. Obviously, there is some apprehension.

MR. KEEHN. Let me just add that the Bank went through the dealer list over the weekend here in Chicago to see how much [the banks] had advanced to each dealer. Apparently, they had no problems. As I said earlier, the margin call was met with no problem. But if we had another that would be different. But as of now they were quite comfortable with what they had to do to meet this margin call.

VICE CHAIRMAN CORRIGAN. The Dow is now down 16-1/2 points. One other point in response to Ed Boehne's question: There are a couple of situations--the bridge loans outstanding in the hands of the investment banks in particular--that are a matter of some concern. The total outstandings are down distinctly from their peaks, but they are still not inconsequential. And it is also true that a couple of investment banks have rather sizable portfolios of junk bonds, which of course they have to finance on a day-to-day basis. One report, for example, that I had earlier this morning had to do with a house, other than the obvious one, with a portfolio into the several billion dollars. Of course, that portfolio, when you have to take your haircut of 25 or 30 percent, that's not trivial in terms of net [unintelligible] or liquidity of the balance sheet. So there are concerns ahead but at least at the moment I would stand by my earlier comment that the concerns are weighty but they are not overwhelming. I think the crucial thing is how these markets behave over the next few hours.

CHAIRMAN GREENSPAN. Any further comments?

MR. MELZER. Alan, this is Tom Melzer. Peter mentioned that the reserve projections would indicate a need to take out further reserves. I presume that we'll provide a larger allowance for excess or somehow amend the directive informally in approaching open market operations today.

MR. STERNLIGHT. Well, that was the expectation based on [what we had on Friday]. I didn't see any new projections from this morning, President Melzer, but that was about what our outlook was. I'm sure we're not going to go in and take anything out this morning. I think the question will be how far we feel committed by any expectations growing out of those newspaper articles. I think we'll have the necessary flexibility to deal with it.

MR. MELZER. Okay.

CHAIRMAN GREENSPAN. Any further comments or questions? If not, let's adjourn until 9:00 a.m. Eastern time tomorrow.

END OF SESSION